BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of	)	
	)	
Accounting for Judgments and Other Costs Associated with Litigation	)	CC Docket No. 93-240

REPLY COMMENTS OF COMSAT CORPORATION

Philip L. Verveer
John L. McGrew
Francis M. Buono

Willkie Farr & Gallagher
Three Lafayette Centre
1155 21st Street, N.W.
Suite 600
Washington, D.C. 20036-3384

Its Attorneys

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COMSAT Corporation ("COMSAT"), by its attorneys, hereby submits the following reply to the comments submitted in response to the Commission's Notice of Proposed Rulemaking in the above-captioned proceeding.[1] In general, the commenting parties agree that it is both unnecessary and inappropriate, as a matter of law and sound public policy, for the Commission to abandon its traditional accounting and ratemaking policy with respect to costs incurred in connection with litigation involving alleged violations of the antitrust laws and other federal statutes.

As the initial comments submitted by COMSAT and others indicate, the outcome-dependent approach reflected in the proposed new litigation cost rules is at odds with the applicable legal standard established by the Supreme Court and, until recently, embraced by the Commission itself.[2] The traditional ad hoc approach utilized by the Commission since its inception presumes

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[1] Accounting for Judgments and Other Costs Associated with Litigation, Notice of Proposed Rulemaking, CC Docket No. 93-240, FCC 93-424 (released September 9, 1993) ("Notice"). For convenience, all initial responses to the Commission's Notice are identified herein as "Comments" (e.g., "COMSAT Comments").

[2] See COMSAT Comments at 1-3; BellSouth Comments at 1-2, 5-10; Southwestern Bell Comments at 1-8.

good faith on the part of regulated carriers, while providing for the disallowance of expenses which are demonstrably exorbitant, unnecessary, wasteful, or otherwise imprudent.[3] The proposed rules would discard this time-tested standard by creating a blanket presumption of disallowance based solely on the ultimate outcome of the litigation (i.e., its "success" or "failure," in a technical legal sense). This approach is in clear conflict with the Court of Appeals' ruling in the Litton Accounting Appeal decision.[4] In that decision, as COMSAT and others have observed,[5] the D.C. Circuit specifically rejected an earlier attempt by the Commission to depart from its traditional ad hoc approach and to adopt a policy which made the carrier's "success" or "failure" in an antitrust suit the sole determinant of the presumptive allowance or disallowance of litigation expenses, concluding that "pertinent decisions convince us that logic and reasonableness require a wider and more discriminating focus."[6] Indeed, the Litton Court went on to observe that "the tension between longstanding judicial and [the FCC's] newly devised administrative procedures could hardly be more severe."[7]

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[3] See COMSAT Comments at 1-2 and sources cited therein.

[4] Mountain States Telephone and Telegraph Co. v. FCC, 939 F.2d 1021 (D.C. Cir. 1991) ("Litton Accounting Appeal").

[5] See COMSAT Comments at 4-6; BellSouth Comments at 8-9; Southwestern Bell Comments at 7-8.

[6] Litton Accounting Appeal, 939 F.2d at 1033 (emphasis added).

[7] Id. at 1034. Nor is the Commission free to ignore the Litton Court's ruling and adopt the proposed rules based solely on its own selective reading of the Court of Appeals' opinion in the Litigation Costs Decision. Mountain States Telephone and Telegraph Co. v. FCC, 939 F.2d 1035 (D.C. Cir. 1991) ("Litigation

(continued...)

More fundamentally, the comments submitted in opposition to the current proposal clearly demonstrate that the proposed rules have no valid foundation in fact, law, or policy. In addition, they would create incentives for behavior by the affected carriers and their competitors that would have a substantial adverse impact on competition and the very ratepayer interests which the rules purport to protect.

As COMSAT and others have observed, adoption of an outcome-based blanket presumption is particularly inappropriate in the complex realm of antitrust law, where there is no "bright line" separating vigorous competition from behavior that may later be deemed to constitute a technical antitrust violation.[8] In its initial comments, COMSAT further noted that a blanket presumption of cost disallowance wherever an antitrust suit is not resolved on the merits in favor of the defendant will have a substantial chilling effect on the affected carriers' incentives to engage in

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[7](...continued)
Costs Decision"). As the comments submitted by COMSAT and others make clear, it is the Litton ruling -- which specifically rejected the Commission's proposed use of a blanket presumption of disallowance based on the outcome of the litigation -- that bears most directly on the fundamental issue raised by the Commission's latest proposal. See e.g., COMSAT Comments at 6-8; U S West Comments at 2-4. In contrast, the selected passages of the Litigation Costs Decision which the Notice invokes in support of the proposed rules are merely dicta to an order vacating the revised rules previously adopted by the Commission. U S West Comments at 3-4.

[8] See COMSAT Comments at 9-12; BellSouth Comments at 24-28; USTA Comments at 10, n.18. As COMSAT has previously observed, there is often no clear "winner" and "loser" in complex antitrust litigation. COMSAT Comments at 11. In this context, a blanket presumption based solely on the technical "success" or "failure" of the carrier in defending against such claims simply cannot serve as a meaningful indicator of whether a carrier's litigation-related expenses were prudently incurred.

meaningful price competition and other pro-competitive behavior which provides direct benefits to the carriers' ratepayers, as well as indirect benefits to consumers of products and services provided by the carriers' customers.[9] Moreover, as BellSouth observes in its initial comments, "[t]o the extent [the carrier's] competitors are successful, not because of their business acumen but because the Commission's proposed litigation cost rules dull carrier incentives to compete aggressively, the remaining ratepayers of the carrier will be harmed."[10] As these comments suggest, the risks to ratepayers and other consumers arising from the perverse economic incentives created by an outcome-based presumption of disallowance are both real and substantial, particularly in today's highly dynamic and increasingly competitive telecommunications marketplace.[11]

The potential adverse impact of the Commission's proposed rules with respect to the treatment of costs associated with

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[9] COMSAT Comments at 10-11. See also BellSouth Comments at 21 ("[I]f the proposed rules require that regulated carriers forego aggressive competition in order to avoid potential disallowances, ratepayers will surely be the loser").

[10] BellSouth Comments at 21-22.

[11] In contrast, MCI's suggestion that in the absence of such a presumption, the carrier would have "no economic incentive to obey federal statutes" (MCI Comments at 4) is without foundation, particularly in the antitrust context, where the threat of treble damages suits, injunctive relief, and other criminal and civil penalties all serve to provide strong incentives for carrier compliance. Contrary to MCI's apparent assumption, the Commission's traditional ad hoc approach does not guarantee that "any loss suffered would be chargeable to the ratepayer." Id. at 5. Given the Commission's well-established authority to disallow any such expenditures upon a proper showing, any assertion that the Commission would somehow "create a perverse incentive to violate federal laws" if it declines to alter its current accounting and ratemaking policy (Id.) is entirely without merit.

antitrust settlements is particularly pronounced, given the high percentage of antitrust claims that are resolved in this fashion.[12] In this regard, there is near unanimity among the commentors that the presumptive disallowance of virtually all such costs is inappropriate as a matter of law and policy. As COMSAT and others have observed, the Commission's proposal wholly ignores the multiplicity of factors that may lead to settlement of a lawsuit, particularly in an area of the law as complex and dynamic as the antitrust field.[13] In addition, the proposed rules introduce artificial incentives to litigate which directly conflict with well-established congressional, judicial, and regulatory policies that are designed to encourage settlement of such disputes.[14]

The disparate treatment of pre-judgment and post-judgment settlements (which would be presumptively disallowed in their entirety) under the proposed rules creates an artificial incentive to settle prior to judgment, as well as an added incentive to litigate after an adverse judgment, even where the cost of appeal exceeds the cost of a post-judgment settlement.[15] Moreover, the existence of the artificial incentives created by the proposed rules will encourage opposing counsel to add (or threaten to add)

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[12] See COMSAT Comments at 13, n.30.

[13] See id. at 14-15; USTA Comments at 23-24.

[14] See e.g., COMSAT Comments at 15; BellSouth Comments at 28-30; Comments of Pacific Bell and Nevada Bell at 5-7, and sources cited therein. As COMSAT has previously observed, the Commission's proposed treatment of settlement costs also accentuates the "chilling effect" of the proposed rules on otherwise pro-competitive carrier behavior. COMSAT Comments at 15.

[15] See COMSAT Comments at 17-20; Southwestern Bell Comments at 18; BellSouth Comments at 30-31.

antitrust or other federal statutory claims to existing litigation, in an effort to gain a strategic advantage, thereby further adding to the costs of litigation (or settlement) incurred by carriers and, in many instances, their customers.[16]

COMSAT's objections to the proposed treatment of other expenses incurred by carriers in connection with litigation involving alleged violations of the antitrust laws are supported and amplified in the other comments submitted in this proceeding. In this regard, the revised rules described in the Notice remain fundamentally flawed in several respects. First and foremost, the proposed litigation expense rules rest on the same basic premise rejected by the Court of Appeals in the Litton Accounting Appeal, i.e., the misguided notion that the Commission's presumption with respect to the allowability of such costs should be entirely dependent on the technical "success" or "failure" of the litigation.[17]

While the current proposal differs from the rule considered by the Litton Court, in requiring that litigation expenses be accrued in a balance sheet deferral account, rather than an operating account, pending the outcome of the litigation, this change merely exacerbates the conflict between the proposed rules and established accounting and rulemaking principles. As the comments recognize, the deferral accounting method is even more

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[16] Southwestern Bell Comments at 16. The proposed "deferred accounting" treatment of litigation expenses gives a carrier's adversaries a further incentive to assert questionable antitrust counts and other federal claims, resulting in increased costs to carriers and their ratepayers. See discussion at 7, n.22, infra.

[17] See COMSAT Comments at 21-22.

onerous to carriers than the "recapture" method previously proposed by the Commission.[18] Indeed, the Commission itself previously rejected this approach in its 1987 Litigation Costs Order,[19] citing "problems of both burdensome administration and inconsistency with fundamental accounting principles."[20] Several commentors have noted that the current proposal is contrary to the treatment of litigation costs under Generally Accepted Accounting Principles ("GAAP") and under Part 32 of the Commission's own rules.[21] The proposed rules also create artificial incentives for competitors to assert antitrust or other federal statutory claims which otherwise might not have been pursued in order to gain a strategic advantage, to the detriment of the carrier, its ratepayers, and shareholders.[22] In addition, they create an anomalous "double standard" under which "carriers might face a one-time lump sum [below-the-line] charge at the conclusion of any litigation that is deemed adverse, but would be required to amortize the same amounts over a period of years if the carrier should prevail."[23] Moreover, as COMSAT and others have pointed out, the proposed rules unfairly

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[18] See BellSouth Comments at 32, noting that the deferral accounting method "requires that investors bear the full cost of litigation, without recovery in regulated rates, throughout the duration of the lawsuit."

[19] Accounting for Judgments and Other Costs Associated With Antitrust Lawsuits, Report and Order, 2 FCC Rcd. 3241 (1987).

[20] Id. at 3247.

[21] See BellSouth Comments at 11-12; Southwestern Bell Comments at 20-22.

[22] Southwestern Bell Comments at 4-5; BellSouth Comments at 22-23.

[23] USTA Comments at 20.

deprive carriers of the opportunity to recoup prudently-incurred costs associated with antitrust litigation or other federal statutory claims for what may be an extended period, even where the carrier's conduct is ultimately found to be wholly within the law.[24]

In the final analysis, however, the most compelling reason for retaining the Commission's existing treatment of litigation expenses is the magnitude of the direct and indirect costs which implementation of the proposed new rules would impose on carriers and their customers. As the initial comments clearly demonstrate, the direct costs associated with the establishment and ongoing operation of a system for tracking and reporting litigation costs incurred in connection with lawsuits involving alleged antitrust violations and other federal statutory claims are likely to be quite substantial.[25] In those cases where the outcome of the litigation triggers a presumption of disallowance (i.e., adverse judgments and settlements), additional resources will be expended and further costs incurred by carriers, by the FCC staff, and (if the Commission's determination is appealed) by the courts.[26] The overall costs of implementing the new rules, which are potentially enormous, will impose significant economic burdens on ratepayers, shareholders, and taxpayers.

In addition to these direct costs, implementation of the proposed rules would impose substantial indirect costs on the

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[24] COMSAT Comments at 24; BellSouth Comments at 33-34.

[25] See BellSouth Comments at 17-20; USTA Comments at 26-28; Southwestern Bell Comments at 22-25.

[26] See BellSouth Comments at 18.

affected carriers' investors, ratepayers, and other consumers. As the comments submitted by BellSouth suggest:

> [T]o the extent that investors perceive that carriers' ability to recover their operating costs are artificially impaired by the proposed rule, the investors' risk, and hence required return, will increase. In addition, to the extent that the Commission requires deferred recovery of litigation costs, investors will be forced to supply additional operating capital to the carrier. This will result in increased cash working capital requirements.[27]

As the discussion above demonstrates, adoption of the proposed new litigation cost rules also would have a significant "chilling effect" on the affected carriers' incentives to engage in vigorous pro-competitive behavior.[28] Moreover, it would create artificial incentives for competitors to engage in litigation in lieu of legitimate competition, thereby imposing additional indirect costs on the carriers' customers and other consumers of telecommunications-related products and services.[29] The comments addressing this issue indicate that these indirect costs, together with the direct costs of implementing the proposed rules, "far outweigh any perceived ratepayer benefit that may result from disallowed expenses."[30]

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[27] BellSouth Comments at 21.

[28] See discussion at 3-4, supra.

[29] See discussion at 5-7, supra.

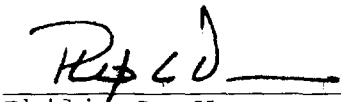
[30] BellSouth Comments at 22. In this regard, BellSouth notes that "[d]uring the more than four years that the vacated rules were in effect, BellSouth did not incur a single adverse antitrust judgment or settlement that would have triggered a disallowance." Id. at 20.

CONCLUSION

As the initial comments submitted by COMSAT and others clearly demonstrate, the new rules described in the Commission's Notice conflict with well-established accounting and ratemaking principles, and would impose substantial direct and indirect costs on the affected carriers and their investors, ratepayers, and other consumers. Accordingly, COMSAT again urges the Commission to terminate the instant proceeding and continue to employ its existing ad hoc accounting and ratemaking treatment of litigation costs, which strikes an appropriate balance that serves to protect the legitimate interests of carriers and ratepayers.

Respectfully submitted,

COMSAT CORPORATION



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